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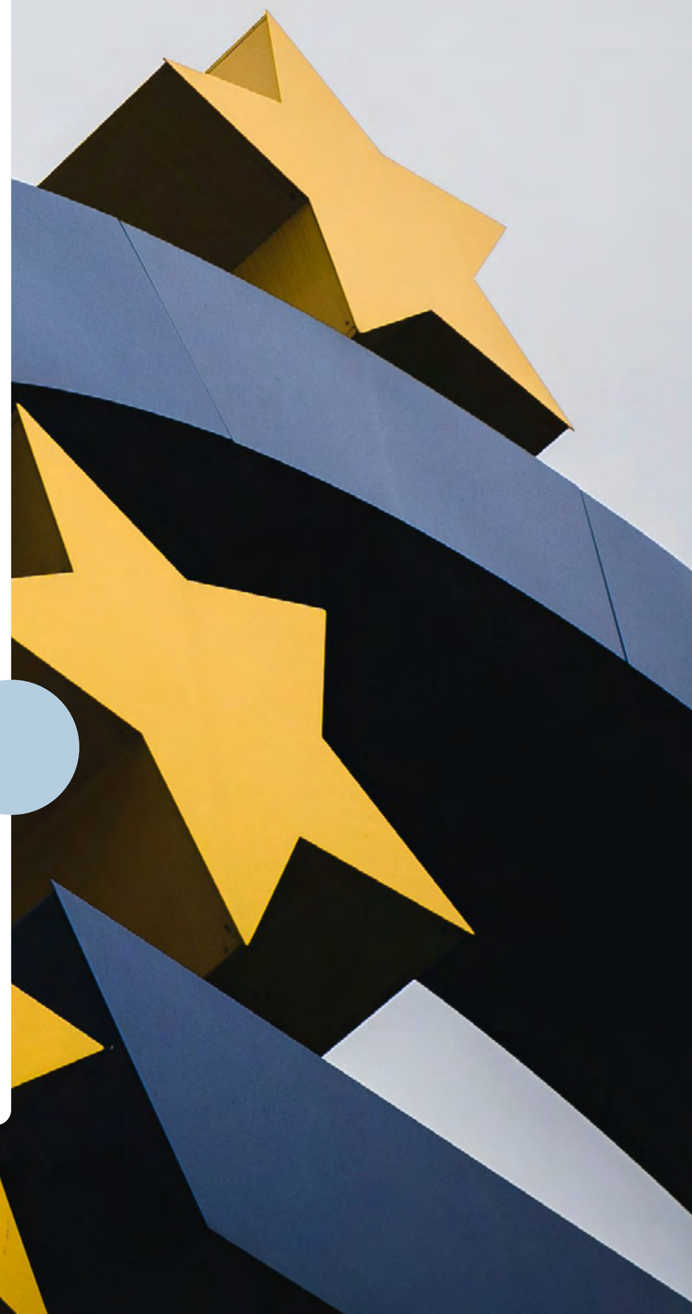
# Guardian of the Euro Galaxy

## The ECB Braces for Liquidity Shift



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Marketing communication

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He began his career in 2004 working with derivatives in Calyon's middle office, moving to Crédit Lyonnais Asset Management as a money market fund manager assistant. In 2005 he joined CIC - Banque Transatlantique as an equity and bond manager.

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Executive summa-ry.

# Executive summary.

**The European Central Bank (ECB) has undergone a significant transformation, evolving from a passive observer to a proactive guardian of financial stability in the eurozone.** As the ECB normalises its monetary policy after a period of unconventional measures, a key challenge has emerged: managing excess liquidity. This paper explores the ECB's evolving role in addressing this challenge.

**Key findings:**

- **The ECB faces a delicate balancing act:** taming inflation while supporting economic growth, maintaining financial stability, and avoiding market disruptions.
- **The current strategy** involves gradually reducing excess liquidity through quantitative tightening (QT) and other instruments.
- **The ECB is considering a more flexible, demand-driven approach** to liquidity management in the future, potentially including a hybrid corridor-floor system.
- **The tightening measures are expected to revive money market funds (MMFs)** as an attractive alternative to bank deposits.

**The ECB's success hinges on its ability to carefully navigate this complex landscape.** Clear communication, measured actions, and innovative solutions will be crucial for ensuring a smooth transition and long-term financial stability in the eurozone.

# Introduction: The ECB's Transformation and Liquidity Dilemma.

**The ECB is ready to do whatever it takes to preserve the euro.**

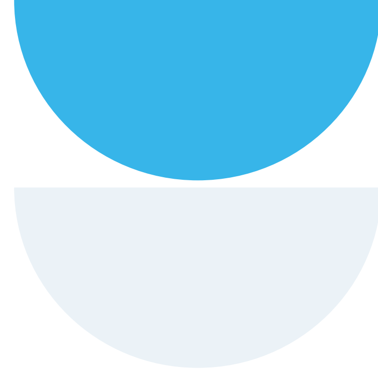
**- Mario Draghi, then President of the European Central Bank at the Global Investment Conference in London, 26 July 2012**

Gone are the days when the European Central Bank (ECB) stood on the sidelines, monitoring inflation and the money supply. After more than 15 years of change, the ECB has emerged as a stalwart guardian of the euro area's financial stability. The turning point came during the 2008 financial crisis, which exposed the shortcomings of a singular focus on inflation. As the crisis developed into a liquidity and banking emergency, pressure mounted on the ECB to take decisive action.

Under the leadership of Mario Draghi, the ECB underwent a dramatic transformation, moving from passivity to proactive interventionism, armed with a formidable arsenal of tools to safeguard the euro area. A defining moment came in 2012. In a memorable speech, then President Mario Draghi declared the ECB's unwavering commitment to preserving the euro area: "*Within our mandate, the ECB is prepared to do whatever is necessary to preserve the euro. And believe me, it will be enough (...) So we have to deal with this financial fragmentation by addressing these issues.*"

The sovereign debt crisis, in which several European governments struggled to borrow money between 2010 and 2012, forced the ECB to provide extensive and unlimited support to all euro area countries facing sovereign bailouts. This move averted immediate disaster, but it inflated the ECB's balance sheet to unprecedented levels and flooded the market with liquidity.

As the environment has evolved since then, the ECB faces a new challenge. It must now recalibrate its framework in order to maintain control over its primary instrument: the short-term interest rate. The recent unwinding of its balance sheet and the efforts to normalise the situation require further adjustments to the monetary policy framework.



In this evolving environment, the ECB faces critical decisions that will have a profound impact on the course of euro area finance. These decisions carry considerable weight as the ECB navigates interest rates and excess liquidity in an economic landscape that has evolved beyond its original framework.

The looming question is whether President Christine Lagarde will maintain the current "floor system", return to the pre-crisis "corridor system" or perhaps introduce a hybrid model combining control and volatility.

# From Price Guardian to Eurozone Anchor.

The European Central Bank has come a long way since its creation in 1999. Initially tasked with the primary objective of maintaining price stability, as laid down in the Treaty of Amsterdam, the institution, now headed by a former Managing Director of the International Monetary Fund and ex-French Economy Minister, has become a cornerstone of the euro area financial system.

While the ECB has taken centre stage, eurozone member states deserve recognition for their efforts to uphold European unity. Nevertheless, the ECB's role has become significantly more proactive in response to the multiplying crises that emerged after 2008.

In the wake of Draghi's tenure, the ECB ushered in an era of substantial monetary intervention, characterised by numerous interest rate adjustments, the introduction of negative interest rates, liquidity injections and large-scale bond purchases. Throughout the pandemic, the ECB played a pivotal role in supporting the euro area economy and addressing the subsequent challenges posed by rising inflation.

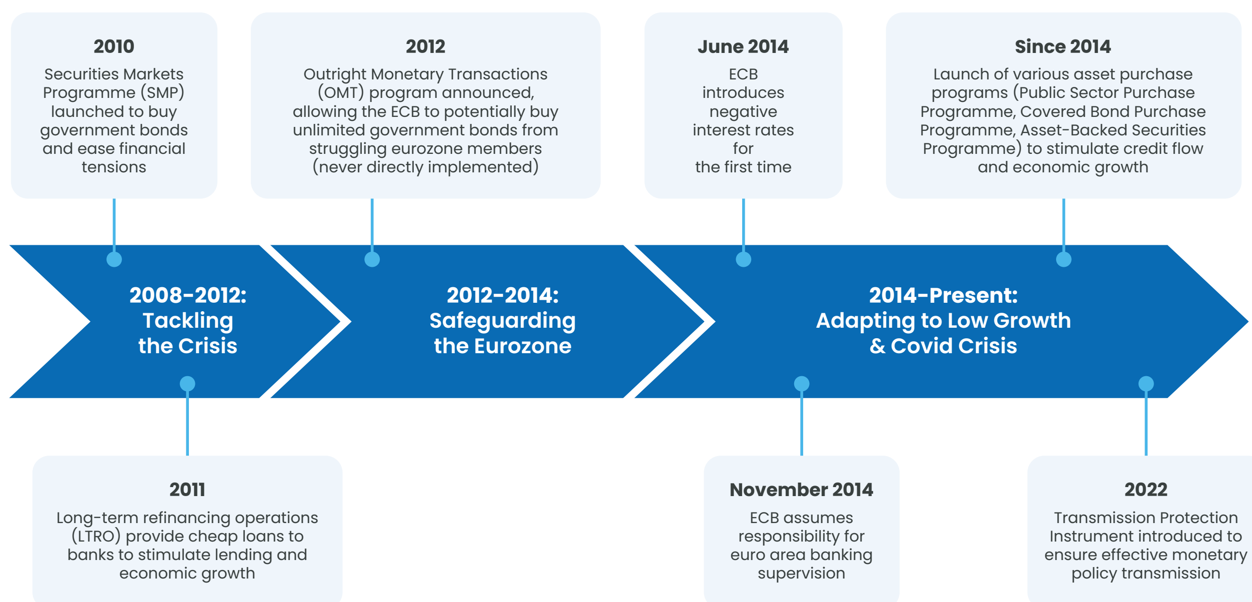
# Unconventional Measures for Unprecedented Challenges

While inflation remains a core objective, the 2008 crisis exposed vulnerabilities in the euro area that called for a more proactive ECB. This period marked the beginning of a significant shift, with the central bank implementing several unconventional measures that were instrumental in preventing a financial meltdown and stabilising the euro area economy.

They helped to:

- **Restore confidence in the European financial system**: by ensuring that banks had sufficient liquidity, the ECB reassured investors and prevented a wider financial panic.
- **Stimulate lending & preventing deflation**: increased liquidity encouraged banks to lend more freely to businesses and households, thereby supporting economic activity. By increasing the money supply, and support financial activity the ECB helped prevent inflation from falling too low, which could have further hampered economic growth.

**Figure 1:**
ECB's Responses to Crises




Source: ECB, Candriam, May 2024

# The Impact on the ECB's Balance Sheet

The various large-scale asset purchase programmes implemented by the Bank in the face of a prolonged low-growth environment have significantly expanded the institution's balance sheet over the past decade.

## The ECB’s Balance Sheet in Brief

Given its crucial role in shaping market dynamics and guiding monetary policy, the ECB's balance sheet has become a key tool for managing financial complexity. It reflects both the size and the composition of the ECB's assets and liabilities.

A simplified breakdown of the ECB's balance sheet is presented below:

### Assets

- **Main refinancing operations (MROs) and longer-term refinancing operations (LTROs):** Main and longer-term refinancing operations provide liquidity to banks.
- **Monetary portfolios:** These portfolios, including the Asset Purchase Programme (APP) and the Pandemic Emergency Purchase Programme (PEPP), inject liquidity into the system.
- **Other assets:** These include non-monetary assets such as gold, IMF claims, and foreign exchange reserves, among others.

### Liabilities

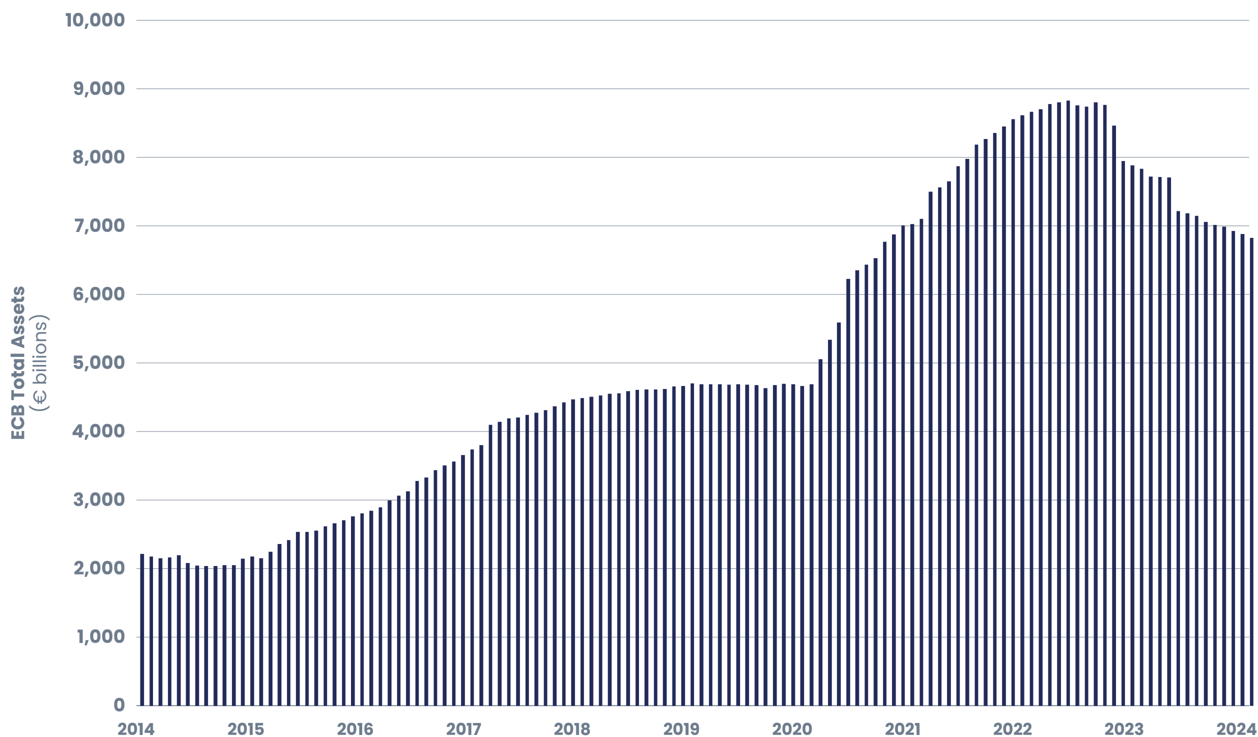
- **Deposits of banks:** Sum of banks' current accounts and the deposit facility.
- **Government deposits:** Deposits of EU governments.
- **Foreign deposits:** Deposits of foreign official institutions.
- **Other deposits:** Deposits of EU non-bank financial institutions.
- **Banknotes :** Euro banknotes in circulation. They are distributed among the different national central banks and the ECB according to the banknote allocation key agreed by the Governing Council.
- **Other liabilities:** These include capital, and revaluation accounts.

Certain elements of the ECB's balance sheet, known as "autonomous factors", are outside its direct control. These factors have a significant impact on liquidity conditions, but are not a direct result of the ECB's monetary policy operations or reserve holdings. These autonomous factors can be a significant source of uncertainty in forecasting future liquidity needs within the banking system.

## ECB Pumps Up the Eurosystem

Excess liquidity, which refers to the surplus of cash in the banking system beyond minimum reserve requirements, is directly impacted by the size and composition of the ECB's balance sheet. When the ECB conducts financing operations for credit institutions, as it has done over the past decade, it injects liquidity into the financial system. This liquidity flows through the system and is eventually settled as deposits on the liabilities side of the ECB's balance sheet. Conversely, reducing the size of its balance sheet, through measures such as tapering asset purchases, reduce excess liquidity.

**Figure 2:**
Eurozone Liquidity: A Trillion-Dollar Surge




Source: Candriam, Bloomberg, March 2024

For reasons explained earlier, the ECB's balance sheet has expanded significantly since 2012, reaching almost €9 trillion through bond purchases and lending operations. More recently, the ECB's unconventional monetary measures have been gradually reduced, bringing its balance sheet down to €7 trillion. This is due to the phasing out of loans to commercial banks and the reduction in bond purchases as a result of the observed calm in the banking sector and rising inflationary pressures.

## Risks and Benefits of Excess Liquidity

Managing excess liquidity is a key task for central banks. Excess liquidity can support financial stability and therefore plays a crucial role in shaping the effectiveness of monetary policy. It dramatically reduces the volatility of short-term interest rates, thereby smoothing the transmission of monetary policy to the economy as a whole. It can also pose risks, such as fuelling asset price inflation or distorting market functioning.

However, a reduction in liquidity could limit banks' ability to lend, thereby hampering economic activity. Conversely, it can lead to increased volatility in short-term interest rates, which can negatively affect the transmission of monetary policy to the wider economy. Therefore, central banks need to carefully assess the optimal level of excess liquidity to achieve their policy objectives while mitigating potential side effects.

**In response to the evolving economic conditions, the ECB has actively reshaped its approach to addressing the emerging challenges, with a particular focus on the expansion of its balance sheet. The range of measures implemented has raised questions about their impact on liquidity, resulting in banks holding excess reserves above regulatory requirements. As this excess liquidity has significant implications for both financial markets and economic activity, analysts are closely monitoring the impact of these measures on the broader economic landscape.**

The ECB's Path

# The ECB's Path Forward on Liquidity.

The European Central Bank is at a crucial juncture. Having successfully steered the euro area through the 2008 financial crisis, the sovereign debt crisis, the Covid-19 crisis and subsequent economic challenges, it now faces a new and complex challenge: unwinding the significant liquidity measures implemented during these periods. While previous strategies skilfully addressed the challenges of their time, the current landscape requires a recalibrated approach. The ECB faces a delicate balancing act as it seeks to orchestrate a seamless transition to a more normalised monetary policy stance.

## Corridor vs. Floor Mechanisms & Rate Implications

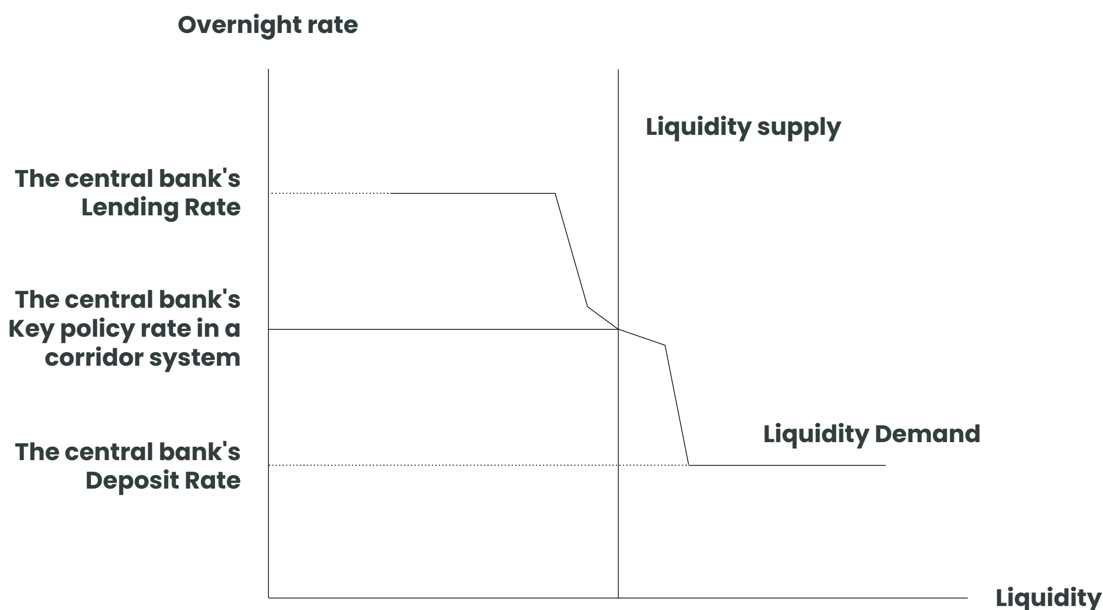
Throughout its history, the ECB has used two main systems to control the amount of money banks hold: the corridor system and the floor system. The pre-2008 corridor system provided precise control over short-term interest rates, but had difficulties in accurately assessing banks' liquidity needs. Conversely, the post-crisis floor system simplified operations but led to reduced interbank activity and other drawbacks.

# The Corridor System: Managing the Flow

Prior to 2008, the ECB operated a "corridor" system of monetary policy, providing banks with tailor-made reserves to keep short-term interbank interest rates within a specified range. The aim of this approach was to ensure that banks primarily exchanged liquidity in the interbank market rather than borrowing from the ECB's marginal lending facility[1] or depositing cash in the deposit facility.

In practice, this system implied that interbank rates would move between the deposit rate (the lower bound) and the marginal lending facility rate (the upper bound), with the ECB adjusting the liquidity provided through refinancing operations in order to steer rates towards the middle of the corridor (T1 in the figure 4).

**Figure 3:**
The Corridor System




Demand for and supply of liquidity in a corridor system with reserve requirements over a maintenance period.

**Source: Candriam, March 2024**

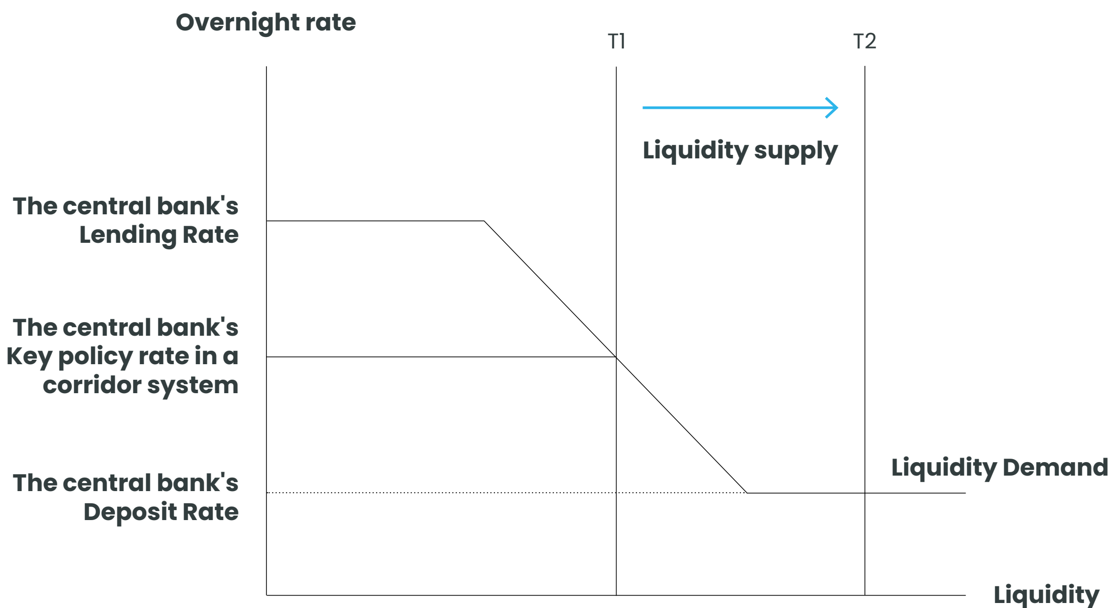
1 - The marginal lending facility rate is the interest rate banks pay when they borrow from the ECB overnight. When they do this, they have to provide collateral, for example securities, to guarantee that the money will be paid back.

However, this system posed challenges, in particular in accurately gauging banks' liquidity needs. An overestimation could disrupt short-term interest rates, while an underestimation could lead to liquidity shortages, especially at certain times. In addition, frequent recourse to the marginal lending facility could imply financial weakness, which could damage a bank's reputation and discourage its use, thereby reducing its effectiveness.

## The Floor System: A Flood of Cash

Since 2014, the European Central Bank, much like the Federal Reserve (Fed), has maintained its role as financial firefighter, but the flames have died down. This involves injecting liquidity into the financial system through bond purchases and regular bank lending operations (refinancing operations). At present, banks are awash with reserves, anchoring short-term interest rates close to the ECB's deposit rate (T2 in the figure 4) - the rate at which banks can deposit excess cash.

**Figure 4:**
The Floor System




Demand for and supply of liquidity from corridor to floor system.

**Source: Candriam, March 2024**

The floor system appears streamlined and straightforward, as the ECB no longer needs to meticulously fine-tune the exact liquidity needs of banks. However, this seemingly simple solution masks underlying side effects:

- **Reduced interbank activity**: Lower risk appetite due to reduced interbank lending.
- **Asset scarcity:** ECB bond purchases have reduced the availability of high quality assets.
- **High financing costs**: Maintaining excess liquidity at positive interest rates is expensive for the ECB.
- **Compressed term premium**: Excess liquidity dampens risk premiums, flattening the yield curve. While reducing the interest rate differential between European countries was the ECB's initial objective, negative effects emerged later on as the risk associated with countries and debt issuers was no longer perceived.

**Figure 5:**
The Key Differences Between Both Mechanisms

| Feature | Corridor System | Floor System |
|---|---|---|
| **Interbank activity** | Strong incentive to exchange balance sheet reserves between each other, reducing the financial system's reliance on central bank liquidity | Fewer incentives for interbank activity |
| **Risk premium** | Risk fully priced, transparent in instruments | The yield curve flattened and the term premium component of bond yields compressed across the term structure. Asset swap spreads and available collateral affected by ECB tapering |
| **Financial cost** | Very limited costs for ECB | The current environment of positive interest rates, coupled with the ECB's significant excess liquidity and a ballooned balance sheet, are making the situation extremely costly for the central bank[2] |

2 - This is due to the difference between the rate at which the ECB remunerates its reserves and what it earns on its assets, it is now extremely costly for the ECB in the current environment.

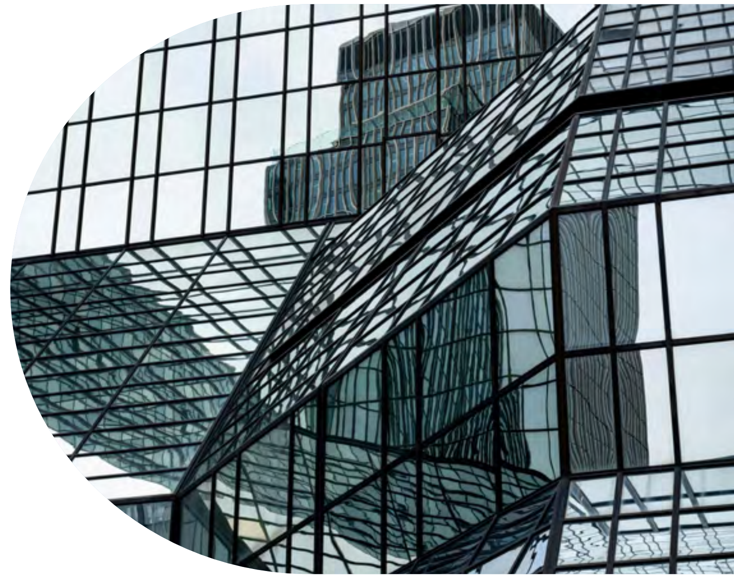
# Navigating the Tightrope of Excess Liquidity

In response to the new economic context characterised by inflationary pressures, the ECB faces a challenging and multifaceted task: to mop up the substantial excess liquidity in the euro area financial system without inadvertently causing unintended consequences.

## A Delicate Balancing

This situation requires a delicate balancing act between several crucial considerations:

- **Inflation vs. Growth:**
    - ***Taming inflation:*** excess liquidity can fuel inflationary pressures by distorting prices. The ECB must gradually reduce liquidity to prevent inflation from spiralling out of control.
    - ***Supporting economic*** growth: reducing liquidity too quickly could dampen economic and banking activity by making credit more expensive for businesses and households. The ECB needs to ensure that the pace of unwinding is measured so as not to hamper growth.
- **Financial stability vs. Market disruptions:**
    - ***Maintaining financial stability:*** a sudden or aggressive withdrawal of liquidity could trigger financial instability by creating a liquidity squeeze in the banking system. The ECB must ensure that the unwinding process minimises risks for banks and other financial institutions.
    - ***Avoiding market disruptions:*** rapid changes in liquidity conditions can lead to market volatility and asset price corrections. The ECB needs to manage the process carefully to minimise disruptions in financial markets.
- **Transparency and communication:**
    - ***Clear communication:*** the ECB must effectively communicate its plans and strategies for managing excess liquidity to market participants. This helps to manage expectations and avoid unnecessary market volatility.
    - ***Maintaining credibility:*** the institution has to demonstrate its commitment to achieving its inflation target and price stability. This strengthens its credibility and helps to anchor inflation expectations and limit asset volatility in the euro area.



## The Current Instruments at the ECB's Disposal

In addition to the key policy rates, the unconventional measures have become crucial to the conduct of monetary policy during the crisis. Withdrawing some of them will be essential to manage the unwinding process, including:

- **Reducing the size of the ECB's asset portfolio (Quantitative tightening, QT):** this involves gradually allowing maturing assets to roll off the balance sheet without reinvesting the principal repayments. This process directly diminishes the amount of liquidity in the system.
- **Rates & allotment procedure for liquidity injections:** Liquidity could be reduced by the fixed or variable rates applied to the one-week and three-month refinancing operations and by partial allotment.
- **Required reserves:** the ECB can gradually increase the minimum reserve requirements, forcing banks to increase the amount of cash they hold in ECB accounts. This can help to mop up excess liquidity.
- **Government deposits:** a change in the cap on the remuneration of government deposits could withdraw liquidity in the banking system (around €150 billion).

**Ultimately, the success of the ECB's balancing act depends on the careful calibration of its actions. The pace and extent of liquidity reduction, as well as the instrument, must be tailored to the evolving economic landscape and market dynamics. This requires thorough analysis and a willingness to adapt the approach as circumstances evolve.**

# The Future of Eurozone Liquidity Management.

With economic conditions strengthening and inflation back to 2%, there is no compelling reason for the ECB to continue to maintain a framework of excess liquidity and a floor.

**Figure 6:**
A Brighter Economic Future

| | 2022 | 2023 | 2024 | 2025 |
|---|---|---|---|---|
| **GDP** | 3.4 | 0.5 | 0.4 | 1.0 |
| **Inflation** | 8.4 | 5.4 | 2.4 | 2.0 |
| **ECB deposit rate** | 2.0 | 4.0 | 3.25 | 2.5 |
| **10-year rate** | 2.6 | 2.0 | 2.5 | 2.4 |

Source: Candriam, Bloomberg, ECB, March 2024

To normalise its approach, the institution has initiated quantitative tightening measures, gradually reducing its balance sheet by tapering bond purchases and allowing maturing bonds to mature naturally. This significant shift from unprecedented monetary stimulus to cautious normalisation is aimed at containing inflation and asset price inflation, while supporting financial stability and economic growth. The ECB needs to manage these measures carefully to ensure a smooth transition without disrupting markets or the broader economy.

# Charting a Course Forward

The future path of excess liquidity management in the euro area is uncertain. With three potential scenarios emerging, each with different implications for financial institutions, market stability and the overall pace of normalisation, innovation will be key for the ECB to manage the excess liquidity it has created.

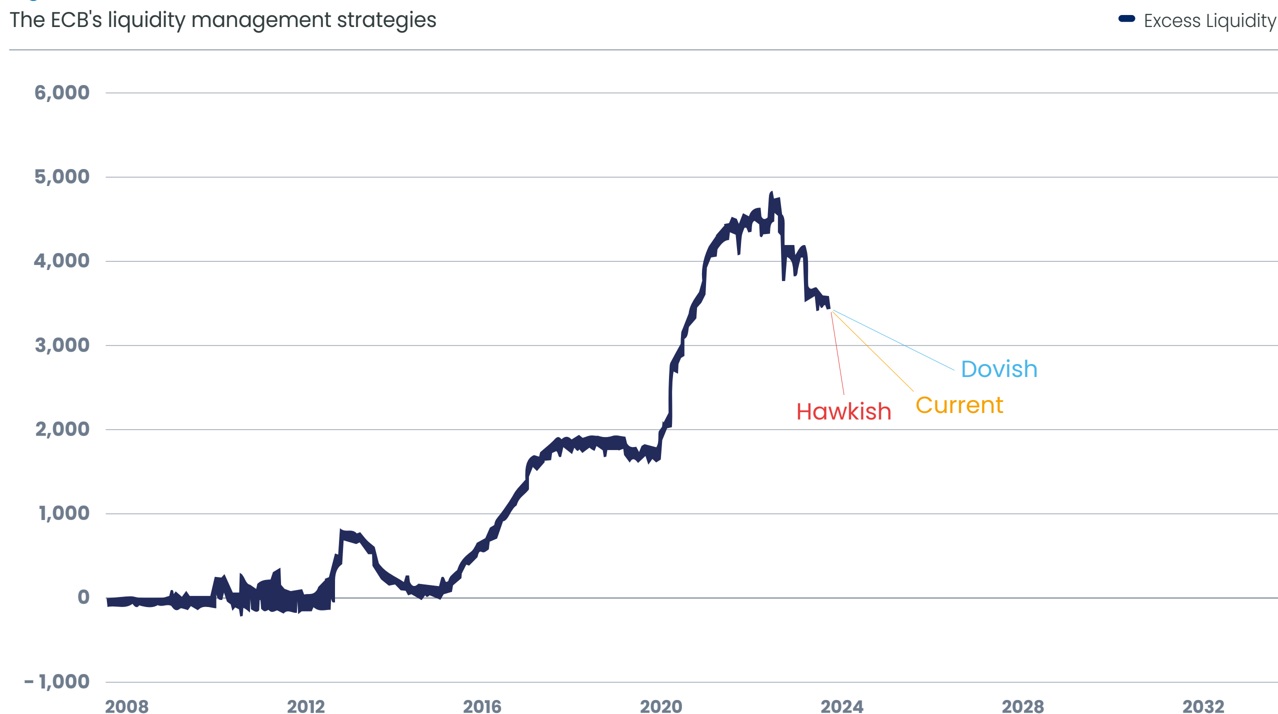
## Monetary Portfolio and Assumptions

According to Isabel Schnabel, a member of the ECB's Executive Board, excess liquidity in the euro area should fall by a further €1.4 trillion to around €2.1 trillion by the end of 2025. How is that possible?

It requires the institution to change its stance, a challenge that unfolds in three different scenarios:

- **Maintain the flow:** In this dovish scenario, the ECB continues to reinvest redemptions from maturing assets in its portfolio. This maintains the current level of liquidity, minimising disruption, but potentially prolonging the unwinding process and hampering efforts to fight inflation.
- **A smooth reduction:** The ECB is implementing a gradual reduction in liquidity by slowing down the reinvestment of maturing assets. This balanced approach aims to control inflation while minimising market volatility. The pace of the reduction would be carefully calibrated on the basis of economic data and market conditions.
- **A rapid reduction:** This hawkish scenario involves a more aggressive approach, with the ECB rapidly reducing liquidity through a significant reduction in reinvestments or even outright asset sales. While it may address inflation concerns quickly, it also carries a higher risk of market turbulence and financial instability, potentially triggering a liquidity crunch for banks.

**Figure 7:**
The ECB's liquidity management strategies



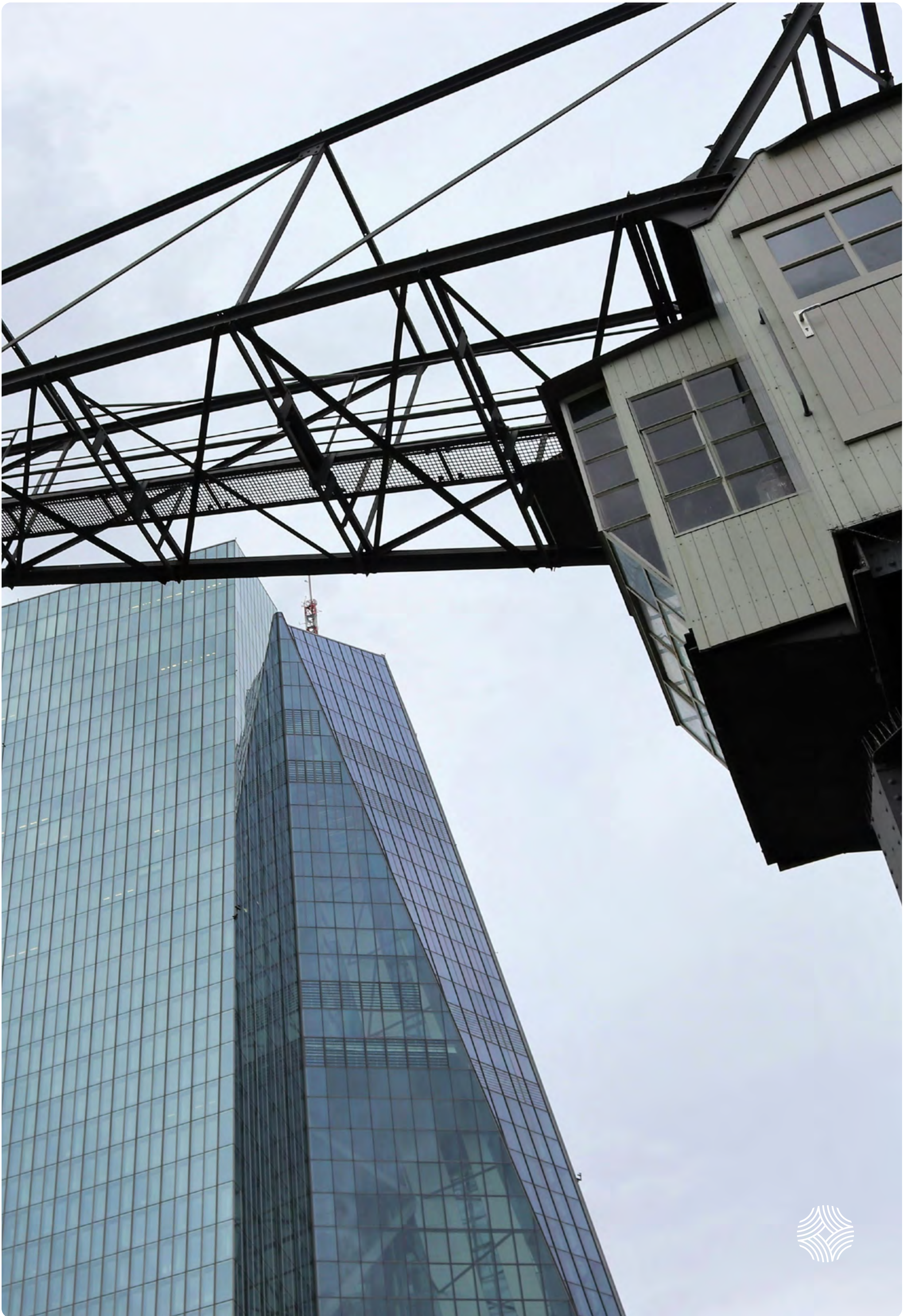

Source: Candriam, Bloomberg, March 2024

Based on a gradual reduction trajectory, euro area excess liquidity is projected to reach around €3 trillion by the end of 2024, exceeding the projections of Isabel Schnabel. By the end of 2025, it is expected to decline further to around €2.4 trillion. This elevated level of excess liquidity is expected to persist until at least 2028, remaining slightly above €1 trillion.

# Future Directions: Innovating for Resilience

Consequently, the ECB has set 2026 as the target date for providing more detailed insight into its two additional innovative programmes which aimed at facilitating a smooth transition during the prolonged period of enhanced liquidity: a structural portfolio of securities and structural longer-term credit operations.

- **Structural portfolio of securities:** the ECB provided few details on its new portfolio, stressing that it won't disrupt monetary policy. Short-dated government bonds will be prioritised to avoid distortions in credit spreads and term premiums. The capital key allocation will remain unchanged



to ensure market neutrality. As this portfolio aims to diversify liquidity instruments and optimise the allocation of resources by allowing targeted injections and a wider range of accepted securities, it could address specific liquidity needs in the financial system while promoting stability.

- **Structural longer-term credit operations:** the ECB has postponed the introduction of new LTROs that could take account of climate change considerations. Details such as allocation methods, interest rates, maturities and collateral requirements are still under discussion. These LTROs, once introduced, could provide banks with regular access to longer-term funding (over 3 months), potentially benefiting lower-rated banks. The ECB aims to design these LTROs in a way that promotes financial stability and supports economic activity.

# The Money Market Phoenix Rises

As economic conditions have improved and inflationary pressures remain present, the ECB is now reviewing its expansionary monetary policy stance, a change that could have important implications for the money markets.

## Money Market Rate Insights

Following the recent ECB's announcements, several important changes could take place in the money markets:

- **Uncertain future for overnight rates:** The introduction of the €STR[3], an interest rate benchmark for eurozone banks, has created ambiguity in the dynamics of overnight rates, traditionally measured by Eonia[4]. Various regulations implemented since 2014 (banking liquidity system) may further complicate the evolution of overnight borrowing costs, leading to uncertainty in the near future. Furthermore, the ECB has decided not to grant non-banks direct access to the deposit facility at this stage, thereby mitigating the immediate impact on the €STR.

3 - The Euro Short-Term Rate (€STR) is an overnight interest rate benchmark reflecting the borrowing costs of banks in the euro area, calculated and published by the European Central Bank.
4 - The Euro Overnight Index Average (Eonia) is the average overnight reference rate for which European banks lend to one another in euros.

- **Reducing excess liquidity:** The ECB's tightening measures are expected to gradually reduce excess liquidity in the euro area financial system. This reduction may lead to a decoupling of the €STR from the deposit rate, potentially widening the €STR/BOR[5] basis and increasing short-term borrowing costs for banks and other entities. A substantial reduction in excess liquidity, estimated at around EUR 500-750 billion, may be necessary to observe a significant impact on short-term interest rates.
- **Revival of the interbank market:** With reduced access to cheap ECB funds, banks may increasingly rely on interbank lending for liquidity. This could lead to a revival of interbank lending, which over time could boost banks' commercial paper issuance and affect short-term interest rates such as Euribor[6]. The extent of this revival will depend on the severity of the liquidity withdrawal and market conditions.

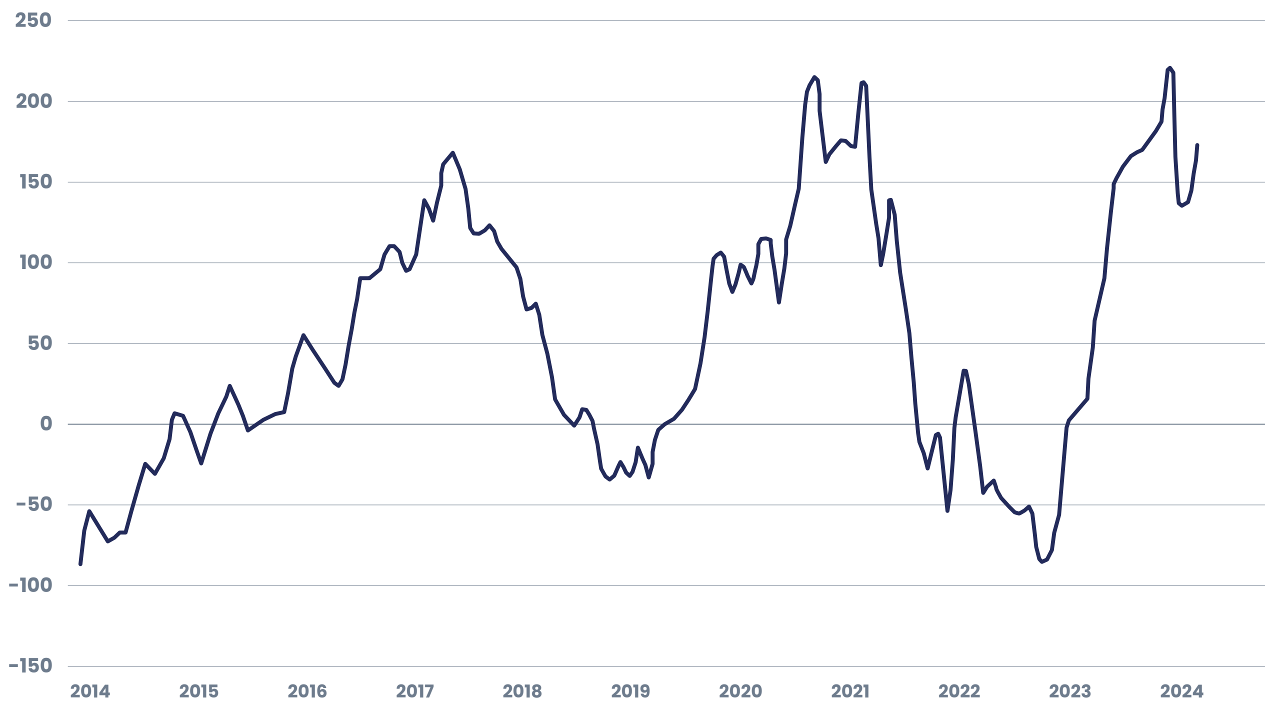
The ECB aims to manage this transition by narrowing the spread between its main interest rate and the deposit rate. This adjustment is aimed at controlling potential volatility in overnight rates and keeping short-term borrowing costs within manageable limits.

## A Potential Resurgence of Money Market Funds?

As the European Central Bank tightens its grip on the money supply, there's a shift underway that could revive an old favourite: money market funds (MMFs). These funds are expected to regain prominence as a key channel for liquidity transmission within the European financial system.

5 - This is the spread between the euro O/N interest rate and the 3-month interbank rate period. A good indicator of the health of the financial sector, measures the risk premium required by a bank to lend liquidity to another bank.
6 - The Euro Interbank Offered Rate (Euribor) serves as the base rate for interbank lending in the European Union and is also used as a reference for setting interest rates on various loans.

**Figure 8:**
European Money Market Funds See Record Inflows




Source: EFAMA-Money Market Funds, Net Sales of UCITS, EUR bn, annual flow, last observation is December 2023.

MMFs may become an attractive choice for investors seeking both safety and potential returns. In current market conditions, holding cash in MMFs may prove advantageous, especially as the yield curve may make cash more profitable than traditional bank deposits. In addition, MMFs offer diversification benefits by investing in different short-term, high-quality assets to spread risk and mitigate market fluctuations. This allows investors to manage volatility while generating income from their cash holdings.

In times of economic uncertainty, navigating the financial markets can be daunting. MMFs offer a simpler solution by pooling investors' funds and employing professional management, allowing individuals to participate in the money market without extensive financial expertise.

# More an Issue of Market Volatility Than a Question of Corridor or Floor

As the limitations of the traditional corridor and floor systems become increasingly apparent, the Frankfurt-based institution acknowledges the need for a more adaptable approach to liquidity management in the eurozone. However, the ECB wants to keep options on the table in order to maintain maximum flexibility without giving too much information to investors, and thus keep control over market volatility until at least 2026.

In such a context, the ECB could choose between two liquidity management systems: a demand-driven floor system or a hybrid approach.

## A Dynamic Demand-Driven Floor System

Under this approach, the ECB would move to a more demand-driven strategy as part of a system where banks can borrow money from the ECB when they need it. This approach would allow banks to request liquidity on an as-needed basis through repo operations, i.e. the arrangements whereby banks borrow money from the ECB in exchange for collateral, as the Bank of England has done.

In contrast to the traditional model, this method aims to enhance the ECB's ability to respond promptly to fluctuations in liquidity demand. By closely aligning the provision of liquidity with market needs, it promotes efficiency, an equitable distribution of liquidity across financial institutions and overall market stability.

## The Hybrid approach

This model combines elements of both the corridor and floor systems, striking a balance between precision and flexibility in liquidity management. By maintaining a level of excess reserves that allows very low volatility in short-term interest rates, while at the same time incorporating aspects of the precision of the corridor system, the ECB aims to optimise the effectiveness of its monetary policy operations.

This strategy allows for a nuanced response to changing market conditions while mitigating potential downsides such as excess liquidity or volatility in short-term interest rates, thereby strengthening the resilience and effectiveness of its liquidity management framework.

**Whatever the future system will be, the ECB is at a crucial juncture, facing the complex challenge of transitioning from unconventional monetary policy to a more normalised stance. The ECB's ability to effectively address excess liquidity, preserve financial stability and promote sustainable economic growth in the euro area will be critical. Navigating this path will require careful planning, innovative thinking and a deep understanding of evolving market dynamics.**

# Conclusion: Embracing Flexibility in a Changing Landscape?

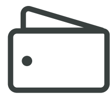
While eurozone members have strived for European unity, the European Central Bank has undergone a significant transformation, moving from a passive observer to an active guardian of financial stability in the euro area. This evolution underlines its commitment not only to controlling inflation and correcting market distortions, but also to fostering sustainable growth. However, navigating the current complex landscape requires a delicate balancing act.

The ECB must respond decisively to pressing issues such as inflation, while retaining the flexibility to adapt to unforeseen circumstances. The deliberate delay in announcing details of new policy instruments until 2026 is emblematic of this approach and of the institution's maturity in communication. This strategic move allows the ECB to minimise market disruption and optimise its ability to respond effectively to evolving economic dynamics.

By taking a measured approach with a gradual disclosure of information, the ECB can ensure a seamless transition to its new policy framework. This promotes market stability by allowing investors the opportunity to adjust their strategies, thereby reducing the risk of potential shocks.

Furthermore, the ECB's tightening grip on the money supply opens the doors for the revival of money market funds as a key player in the European financial system. These funds offer a compelling alternative to traditional bank deposits, particularly in light of a potentially more profitable yield curve. By professionally managing a pool of short-term, high-quality assets, money market funds can help investors weather market volatility and generate income from their cash holdings even in uncertain economic times.

Despite the uncertainties that lie ahead, the ECB's unwavering determination to preserve financial stability inspires confidence in the euro area's long-term prospects. As the Frankfurt-based institution continues to evolve and adapt, its unwavering focus on fostering a healthy euro area economy remains a cornerstone of stability in an increasingly uncertain global landscape.



**€145 B**

AUM at end December 2023*

**+600**

Experienced and committed professionals

**+ 25 years**

Leading the way in sustainable investing

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*As of 31/12/2022, Candriam changed the Assets Under Management (AUM) calculation methodology, and AUM now includes certain assets, such as non-discretionary AUM, external fund selection, overlay services, including ESG screening services, [advisory consulting] services, white labeling services, and model portfolio delivery services that do not qualify as Regulatory Assets Under Management, as defined in the SEC's Form ADV. AUM is reported in USD. AUM not denominated in USD is converted at the spot rate as of 31/12/2023.

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